

READOUT: DG Lane's speech on the Bank of Canada's decision-making in turbulent times

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Hello,

Please find below a readout of the event held by the University of Calgary's School of Public Policy with the Bank of Canada's Deputy Governor, Tim Lane. The Deputy Governor read the attached prepared remarks, and then answered questions from the audience.

Key takeaways & flags:

- Biggest lesson coming out of this economic crisis is the importance of being adaptable and learning to expect the unexpected.
- In response to a question on how the bank can address an increase in government debt, DG Lane reminds the audience that the initial reason for the increase in government debt is the fact that fiscal policy clearly needed to play a central role in addressing the economic consequences of the pandemic, while maintaining the need for long-term sustainability.
- Notes that based just on what we know now that increasing interest rates is needed, but if things go a different direction, then the Bank will have to be prepared to react.
- States that the Bank will have to start considering how to reduce its balance sheet after they increase rates and that it's currently at a much larger level than they expect.
- On the recent blockades across Canada, DG Lane states that just when supply chain constraints were starting to ease, we have these blockades that are causing further problems with supplies, and that the Bank will be assessing the impact at its next rate decision meeting.
 - o Suggests that the impact on the economy as a whole isn't large, but that prolonged disruptions could start to take their toll.

- Notes that the Bank's monetary policies are indeed impacted by decisions made by the US Federal Reserve due to a variety of reasons, and the Bank assesses US macroeconomic policies in its decisions.
- His parting advice for students joining the workforce is that there is a shortage of key skills in the digital sector, and if anyone is still contemplating what to study, those skills are in high demand and in short supply.

Q&A:

Q: With current low interest rates and funds to keep bond holdings constant, what other monetary policy tools does the bank have at its disposal without disrupting economic recovery?

A: Well, at this point, we've already been clear that those conditions are not going to continue that we've, you know, we've the governor, for example, in the press conference after the after the decision in January indicated that interest rates will need to be on a rising path. And that means not just a one off increase in interest rates from a quarter of a percent, but probably is certainly almost certainly a series of rate moves. And that, of course, will have the effect of restraining of restraining inflation as we go forward. He also indicated that we are going to be considering moving out of the reinvestment phase and starting to reduce our holdings of government of Canada bonds and that will have the effect also removing some of that stimulus, which is in the economy because currently our view is that there is no longer, on the whole, economic slack in the Canadian economy or in the labor market and it is now appropriate to start withdrawing some of this emergency monetary policy stimulus and that will have the effect of on the whole will It will have the effect of cooling down the economy but also of bringing inflation back to its 2% target.

Q: What lessons has the bank learned with regards to effectively responding to economic crises without while remaining independent from the Canadian federal government?

A: As I've emphasized at the speech, we've learned to expect the unexpected. As emphasized, things didn't play out quite differently than we expected and I think I think it's really a lesson about being adaptable. It's the fact that you can't get too wedded to your to your initial view, you have to be prepared to change it as new facts come in. And that's never been true more than in this kind of pandemic where you've got events that are unlike any that we've ever seen before, and where we really have to accept the fact that some things are going to play out differently than we might think in advance.

Q: Are you able to comment on the long term impacts of an increase in government debt that has occurred during the pandemic and how the central bank may address that?

A: The initial reason for the increase in government debt is the fact that fiscal policy clearly needed to play a central role in addressing the pandemic, the economic consequences of the pandemic. Monetary policy is too broad based and affects everybody in the economy. Whereas fiscal policy could be more targeted to people who've lost their jobs or businesses that have lost revenues, and it was really appropriate given the unprecedented nature and huge size of the shock that fiscal policy deliver a very strong response and that of course, was reflected in the run up of debt but over the longer term, you have to have a fiscal position that's sustainable and that means that means having a plan to bring the deficit to a state where debt is not going to keep increasing relative to the size of the economy. And that's obviously an essential condition for economic stability going forward.

Q: What benchmarks or conditions will the bank consider on its roadmap to increasing interest rates to achieve its inflation target of 2%?

A: There are some reasons that we think inflation is going to come down in the second half of this year as some of the supply constraints ease and we've seen that some of the shortages, for example, the shortage of semiconductors in the auto industry, have eased and that's meant that some of the car producers that were, as we've heard it, basically producing cars, almost finishing producing cars, and but not being able to put the semiconductors in at the end, they were sort of waiting for the

parts to arrive. And so you had a lot of cars that weren't available, households that are prepared to wait to get delivery of cars and, and meanwhile, nobody's offering discounts on them. And so car prices were higher. But obviously we've seen that those shortages have eased, we've had some of the semiconductors delivered and so as that kind of thing happens and I don't just mean semiconductors, but across a whole range of things that they constrained, then we'd expect inflation to be coming down later this year. But, of course, we're going to be watching that very closely and if we see signs that inflation is still more persistent, that would on the whole tend to lead us to be more concerned about the risks that inflation is persistently higher and that we actually need to do more in order to bring inflation back to its target. So again, our baseline is that we will be needed to increase interest rates, just based on what we currently know, but if things seem to break in a different direction because we're not seeing that relief of supply constraints that we expected that we're going to have to be prepared to react to that.

Q: Is there a certain period of time that you think will be needed to bring the bank's balance sheet, and perhaps the balance sheets of some of our peer countries' central banks back to a more normal level?

A: We're going to certainly consider starting that process as soon as we're starting to raise rates and quite likely we'll be saying something about that. In a couple of weeks' time when we're actually at the next decision point. So we will be making some announcements before very long about what kind of path we're likely to be following in terms of moving our balance sheet back to normal. It's at a much larger level than we expect. It to be to be over the longer term. And so there will be a process but we're not really in a position to make any announcements about that yet.

Q: As you stated in your speech, inflation is very high right now. And we know that racialized communities have been affected disproportionately harder by the rising cost of living. Does the bank recognize this trend? And what policy measures do you recommend to negate this?

A: Inflation affects everybody and we can't, we can't really differentiate we have to deal with the overall price index. And generally what we target is the Consumer Price Index, because that that's sort of a measure of what the average Canadian household is, is spending. And so in that context, we can't really differentiate our monetary policy in any way to target particular communities. But really, we have a target to bring down inflation for all Canadians. And when we do that, it's likely to benefit the communities you referred to as well. So that's kind of how we've been looking at it up to this point.

Q: Could you comment on the impact that recent protests and blockades may have had on inflation or potential interest rate hikes?

A: Don't get me started. I'm aware of a number of businesses having to close because of the harassment that their employees have been facing and that kind of thing, but those impacts are probably not very large in the scheme of the whole Canadian economy, but where the impacts I think were potentially larger were the border crossings and the potential that large amount of Canadian trade could get interrupted and both the export trade, which brings revenues to the exporters and their employees, but also imports of materials and we're already facing the shortages and just when things were starting to ease, we have these blockades that were causing further problems with supplies and we've heard about the auto plants in Windsor and in Detroit that have been suffering from that. So, clearly if these things were to persist, if there were further blockades then they would have an impact on the broader Canadian economy. But at this point, we will be assessing that in our upcoming decision. But hopefully, it won't last long enough to have a major impact. But of course, we're watching that.

Q: To what extent does the Bank of Canada's monetary policies and policy decisions depend on US macro-economic policy moves?

A: US policies certainly have a big impact on Canada through a few channels including for example, as the Federal Reserve tightens, and it has an effect on Canada, first of all, because it affects interest rates in Canada directly because Canada is an open economy. A lot of financial assets are traded between Canada, the US and so, typically, especially for longer maturities, US rates tend to have a large effect on Canadian rates. The second thing, of course, is the direct impact on the US economy because of big effects on Canada. So tightening in the US has an effect on economic activity and inflation in the US which has a direct impact on Canada by traded goods that their prices, and by US demand for Canadian products. And then third, the US monetary policy affects the Canadian dollar vis-a-vis the US dollar because one of the major factors that affects the value of the Canadian dollar is the broader global value of the US dollar and if the US Federal Reserve tightens that pushes up to the US dollar relative to the Canadian dollar. And so that affects the Canadian economy through another channel. So, combining all those effects, certainly we have to look at all those effects in our economic models, as we take those as given in making our decisions on Canadian monetary policy. So, we don't have to move in-step with the Fed, but it certainly has a big impact on the economic conditions in which we make our own decisions to affect inflation in Canada.

Q: Given the bank's comments on labor market tightness in productivity, do you have any advice for students like ours that are entering the workforce?

A: It's certainly much better to enter the workforce at a time of tight labor markets than at a time when there's a lot of unemployment around and so in that respect, things are certainly a lot better than they were years ago. I think what we've seen particularly where we've talked to businesses, we hear a lot of reports from them having shortages of key skills, a bit particularly on the technological side. And the fact that the Canadian businesses are really trying to up their game on the digital side, they're trying to make investments and they're trying to increase their staff in areas related to the digital economy. And that, of course requires having people with those skills and so on. And so that's partly obviously for those students who are lucky enough to have made that choice and to have come out with those skills. It's certainly a very good time, but I think for everybody, for universities and for governments and for students who are contemplating what to study, it's certainly everything related to what's known as STEM - science, technology, and engineering. Those are all skills that are very much in demand and in short supply in Canada, so those are maybe some of the some points. One other thing I'd say is that I think that this experience of the last couple of years just shows us the benefit of being adaptable, and the fact that the economy is changing very rapidly. And I think we all have to recognize that some of our expectations are just not going to be the way things turned out and that really helps to be able to kind of change your direction when things work out differently. And that I think is that is an important lesson for central bankers, but it's also an important lesson, I think, for everybody.

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